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IN THE

Supreme Court of the United States

October Term, 1934

EVELYN F. GREGORY,

Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF AMICI CURIAE

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BRIEF AMICI CURIAE

Pursuant to leave heretofore granted, the undersigned submit this brief *amici curiae.*

The citation to the opinions below, the reference to the jurisdiction of this Court, and the specifications of errors are set forth in petitioner's brief in support of the petition for the writ of certiorari (pages 8-10) and are not set forth herein. Citations

to the relevant statutes are contained in the argument.

QUESTION PRESENTED

Are transactions, expressly within the reorganization provisions of the Revenue Act of 1928, conducted to the end that capital gain may be realized and taxed as such, to be denied their usual effect if the purpose of such transactions is to avoid greater taxes which would result if the sale of the capital asset were consummated in one of several other ways?

IMPORTANCE OF THE CASE

The provisions of law, the interpretation of which is involved in this proceeding, are to be found in the Revenue Acts of 1924, 1926, 1928 and 1932. In large measure the same provisions are repeated in the Revenue Act of 1934. During this ten-year period from 1924 to 1934, while the statutory law relating to transactions involved in corporate reorganizations and relating to the taxation of capital gains remained unchanged, thousands of transactions involving questions of tax liability of corporations and individuals have been consummated, in reliance first, upon the principle that tax liability is determined by the language of the statute and not by an assumed, but unexpressed, legislative intent (*Crooks* v. *Harrelson*, 282 U. S. 55) and second, is not determined by the motive of the taxpayer (*U. S.* v. *Isham*, 70 Wall. 496, *Bullen* v. *Wisconsin*, 240 U. S. 625). Despite these time-honored and presumably well-settled principles of construction, the

Circuit Court of Appeals in effect abandoned them in this case and substituted the principle that the statute should not be literally applied and that the motive of the taxpayer controls.

Such a rule, varying as it necessarily must with the mental processes of each judge called upon to enforce it, would produce untold confusion in disposing of those tax problems already existing by reason of transactions consummated. Such a rule would make it impossible for any taxpayer or his lawyer, in considering future transactions, to determine whether or not the form and manner in which those transactions are to be consummated would result in taxation, or under which of numerous possible provisions of the Revenue Acts such transactions might be taxed.

The very purpose, therefore, of the capital gain provisions to induce (by a reduction in the tax rate) the free and normal sale of capital assets is defeated. Certainty promotes such transactions; uncertainty deters them.

STATEMENT OF THE CASE

The petitioner, Mrs. Gregory, owned all the capital stock of the United Mortgage Corporation. Included among the assets of United Mortgage Corporation was 1,000 shares of Monitor Securities Corporation.

On September 18, 1928, Averill Corporation was organized. Pursuant to a plan of reorganization, United Mortgage Corporation transferred part of its assets, consisting of the 1,000 shares of stock of Monitor Securities Corporation, to Averill Corporation in exchange for the issue by Averill Corporation of all

of its stock to Mrs. Gregory. Mrs. Gregory did not surrender her stock in United Mortgage Corporation and still retains it.

On September 24, 1928, the Averill Corporation was dissolved and distributed in liquidation to Mrs. Gregory, the holder of all of its stock, all of its assets, consisting of the stock in the Monitor Securities Corporation. Also on September 24, 1928, Mrs. Gregory sold the 1,000 shares of Monitor Securities Corporation for cash.

In her income tax return Mrs. Gregory reported a capital gain from the above transaction of $76,007.88 and paid the tax shown thereon to be due. That profit was arrived at by apportioning her cost of United Mortgage Corporation stock, in part, to the stock of Averill Corporation distributed to her and subtracting said cost of Averill Corporation from the value of the Averill stock, which was $133,333.33.

The Commissioner of Internal Revenue determined that she had received an ordinary dividend from the United Mortgage Corporation upon the distribution to her of Monitor Stock and added $133,333.33 to her income, computing tax thereon at ordinary surtax rates. The Board of Tax Appeals sustained the taxpayer and held that Mrs. Gregory realized a capital gain upon the distribution to her in liquidation of the Monitor stock.

The Circuit Court of Appeals, disagreeing with the taxpayer, the Commissioner and the Board of Tax Appeals, held that Mrs. Gregory received a taxable dividend upon the distribution to her of the stock of Averill Corporation and neither a capital gain nor a taxable dividend upon the distribution of the Monitor stock.

SUMMARY OF THE ARGUMENT

The Circuit Court erroneously relied upon *Pinellas Ice and Cold Storage Company* v. *Commissioner* in its decision in this case.

The practical problem in this case is to determine the tax due on the gain derived from the dealings in a capital asset.

The statute is a deliberately planned, integrated and seasoned structure covering, in detail, the disposition of capital assets, exchanges and distribution in connection with corporate reorganizations and the subsequent disposal of stocks, securities and properties received in such reorganizations. Each step taken in the reorganization here involved was contemplated and specifically provided for in the statute. The statute is a carefully articulated plan and there is no room therein for interpolation of an intendment beyond the words used in the statute. It is impossible to depart from the interlocking provisions of the statute without rendering uncertain all capital transactions involved in corporate reorganizations and thus defeating the intention of the Congress to induce the free and normal sale and exchange of capital assets by granting postponement or a lower rate of tax on the profits arising from such transactions.

ARGUMENT

I.

The Court of Appeals erroneously relied upon Pinellas Ice and Cold Storage Company v. Commissioner in its decision in this case.

It was said by the Circuit Court of Appeals (R. 36) in answer to the argument that the statute should be

specifically followed, that in *Pinellas Ice and Cold Storage Company* v. *Commissioner* (287 U. S. 462) "the violence done the literal interpretation of the words is no less than we do here." We think this is entirely mistaken. The *Pinellas* case was actually a decision that the short term notes used as consideration for an exchange did not meet any reasonable definition of the word "securities" as used in Section 112 (b) (4) of the taxing statute. No violence is done to the statutory language by that decision.

In the second place the opinion in the *Pinellas* case dealt with the definition (Sec. 112 (i) (l) (A)) of reorganization by way of "merger or consolidation," including the parenthetical clause which follows. That definition has been recognized as obscure for a number of years and is one leaving much latitude in construing the statute. The case at bar, however, involves the specific definition of reorganization in Section 112 (i) (l) (B). The words are plain; the meaning is clear. Such a literal definition leaves no doubt to be construed.

The *Pinellas* case is, therefore, no authority for the decision below. That case offers no support for a decision in direct conflict with the admittedly clear terms of the sections of the statute involved in the present case.

II.

The practical problem in this case is to determine the tax due on the gain derived from dealings in a capital asset.

The Revenue Act of 1924 and succeeding Acts, including the Revenue Act of 1928, here involved, provided a varying amount of taxes which could be im-

posed upon the realization of gains arising from dealings with capital. The computation of such tax depends upon the form of the transaction actually pursued. For illustration; in the first place, there could be a tax on the realization of gain from the sale of a capital asset by a corporation at the corporate rate of 12% (Section 13). In the second place, if the proceeds of the gain from a sale of a corporate capital asset were distributed by a corporation, there would be a dividend taxable to the stockholder at surtax rates (Section 115 (a), Section 25 (a)) in addition to the tax paid by the corporation on the original gain. In the third place, if the corporation realizing the gain were liquidated thereafter, the gain would be taxable to the corporation (Section 13) and to the stockholder, a second time, as a gain to him on liquidation (Section 115 (c)). In the fourth place, if the property were first liquidated from the corporation and then sold by the individual stockholder, there would be one tax to him on his gain from liquidation (Section 115 (c)) and a second tax, if he sold the property at a profit (Section 112 (a)). In the fifth place, the gain from liquidation of the corporation might be taxed as ordinary gain or capital gain, depending upon whether the gain realized fell within or without the definition of capital gain as contained in Section 101.

From the foregoing it will be seen that the problem in this and similar cases dealing with gains from capital assets is not merely whether *a* tax is imposed, but is a problem of selecting the particular tax intended by the Congress to be imposed upon the particular transaction from among the several taxes which might be imposed. It should be apparent that

there is a well rounded plan of specific and detailed provisions relating to the tax effect of changes of ownership of capital assets. This plan began in the Revenue Act of 1924 and continued in subsequent Revenue Acts.

Both by reason of the number of such provisions involved in the various steps in this case and because of the meticulous care with which those steps were carried out in conformity to the statutory provisions, this case well serves as a general illustration of the statutory plan and is important primarily because it clearly brings home the necessity of adherence to the statute in the decisions of the Courts in order that untold confusion may be avoided, both as to transactions already consummated and as to transactions which may be consummated.

It is important to bear in mind that the gain with which the case is concerned is a gain from dealings in a capital asset; namely, the 1,000 shares of the capital stock of Monitor Securities Corporation. The measure of the profit derived from those dealings and the extent of the tax to be imposed thereon is the sole issue in the case. At some point all parties are agreed that a tax liability arises. The problem is to select the tax which the statute imposes.

When it became apparent that the stock of Monitor Securities Corporation could be profitably sold and, in the judgment of the parties concerned, it should be sold, the remaining problem was to consider the effect of such a sale upon the taxes that would be due upon its consummation. It is idle to assume that either this transaction or any other involving substantial sums of money has been consum-

mated during the last fifteen years without some consideration being given to the effect, in terms of taxes, of what is done. In fact the failure to consider taxes in connection with capital realizations may easily result in such multiple taxes as will in large measure turn an apparently profitable transaction into an actual loss, due regard being had to the fact that out of profits realized in the first instance tax must be paid and the remaining proceeds must seek reinvestment on a profitable basis, in order that capital may not be impaired and that income may continue to be realized. It is to the interest both of the citizen and the Government that these two objectives be attained.

In the absence of taxation the simplest procedure would have been for the United Mortgage Corporation to sell the Monitor stock and distribute the proceeds to Mrs. Gregory. This would have resulted in a profit of the difference between the sales price of $133,333.33 and the cost to United Mortgage Corporation of $10,413.07, or $122,920.26. At the corporate rate of tax of 12 per cent (Section 13, Revenue Act of 1928), the first tax on this transaction would have been $14,550.43. The distribution of the sales price, less the corporate tax, as an ordinary dividend to Mrs. Gregory would have increased her individual income, subject to surtax, in the amount of $118,782.90. This amount added to her ordinary income (R. 28) would have resulted in a second tax of $17,269.07, payable this time by Mrs. Gregory but all attributable to the sale of this single capital asset. The two taxes, corporate and individual, on the transaction so executed would have been $31,819.50, a sum more than 25 per cent of the

profit and nearly 25 per cent of the gross sales price.

Since the assets sold amounted to over 16 per cent (R. 23) of the total value of Mrs. Gregory's stock in United Mortgage Corporation, the transaction obviously represented a substantial return of capital so far as she was concerned, and a transaction carried through as above outlined would give no effect to this capital realization. In view of the policy of the law with respect to capital gains (Section 101, Revenue Act of 1928) calling for liberal interpretation in favor of the taxpayer (*Burnet* v. *Harmel*, 287 U. S. 103; *Helvering* v. *New York Trust Company*, 292 U. S. 455), a tax of 25 per cent on a single capital gain certainly is not to be favored in the construction of the law, and steps taken in reduction of such a tax to the amount found by the Board of Tax Appeals certainly do not warrant attack by the Government or deserve the comment of the Circuit Court in this case (R. 37).

Instead of adopting a procedure which would result in a maximum tax under the circumstances the taxpayer selected a route by which two results were accomplished within the spirit and the literal terms of the statute. First, the capital gain realized would be taxed as such at 12½ per cent (Sec. 101), and second, due effect would be given in the computation of the tax to the actual partial realization by Mrs. Gregory of the cost of part of her stock in the United Mortgage Corporation (Sec. 115 (c)).

The Board of Tax Appeals understood this election and objective of the taxpayer clearly and approved of both. The Court of Appeals, however, ignored the provisions of the statute and imposed a tax as though a dividend had been distributed to Mrs.

Gregory (Sec. 115 a). As a consequence the Circuit Court's decision results in a tax amounting to $22,856.63 or over 30 per cent of Mrs. Gregory's capital gain. The decision of the Circuit Court clearly fails to give effect to the policy of the Congress to limit to 12½ per cent the tax upon capital net gains.

From this we pass to an examination of the several steps actually taken, to demonstrate that those steps, severally and together, fit exactly into the plan and spirit of the statute and result in the imposition of a single capital gain tax in accord with the intention of the Congress expressed in the statute.

III.

The statute is a deliberately planned, seasoned and integrated structure covering, in detail, the disposition of capital assets, exchanges and distributions in connection with corporate reorganizations and the subsequent disposal of stocks, securities and properties received in such reorganizations. Each step taken in the reorganization here involved was contemplated and specifically provided for in the statute.

The statute involved was enacted in all the essentials here applicable in 1924, and re-enacted in 1926, 1928, 1932 and, in large measure, in 1934. The very detail of specification in its provisions indicates the intention to write a statute which "results in definiteness and accuracy and enables a taxpayer to determine prior to the consummation of a given transaction the tax liability that will result therefrom."* Continued re-enactment is the best indication of legislative satisfaction with the result.

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* House of Representatives Report No. 179, 68th Congress, 1st Session, to accompany H. R. 6715, February 11, 1924, p. 13.

Applications of the statute to the transactions accomplished in the case at bar illustrate the detailed extent of the Congressional contemplation and the integration of each step into the structure as a whole.

III-A.

The United Mortgage Corporation transferred to the Averill Corporation 1,000 shares of the capital stock of Monitor Securities Corporation in exchange for all the capital stock of Averill. This step in the series of transactions involved was within the provisions of Section 112 (b) (4) of the Revenue Act of 1928.

The United Mortgage Corporation transferred to the Averill Corporation 1,000 shares of the capital stock of the Monitor Securities Corporation in exchange for all the capital stock of Averill.

Under the Revenue Act of 1918, that transaction, standing alone, would presumably have resulted in taxable gain, although there is no decision of this Court to that effect. The question was involved in *West Point Investment Company,* 1 B. T. A. 436, and in *Wallis Tractor Company,* 3 B. T. A. 981, 999, in both of which cases it was held that a corporate taxpayer realized gain, under the Act of 1918, by the transfer of some or all of its assets for all of the stock of a newly organized corporation.

To demonstrate that under the Revenue Act of 1928 the above first transaction involved in this case is literally within the terms of the statute, it is only necessary to cite Section 112 (b)(4) and Sections 112 (i)(1) and (2), interpolating therein the property and corporate names involved. This citation of Section 112 (b) (4) with the above interpolations reads as follows:

"SEC. 112. RECOGNITION OF GAIN OR LOSS."

"(b) *Exchanges solely in kind.*—"

"(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation"—*United Mortgage Corporation*—"a party to a reorganization exchanges property." —*1,000 shares of the capital stock of Monitor Securities Corporation*—"in pursuance of the plan of reorganization, solely for stock or securities in another corporation" —*capital stock in Averill Corporation*—"a party to a reorganization."

The stock of Monitor Corporation was property (*DeGaney* v. *Lederer,* 250 U. S. 376-380; *Burnet* v. *Brooks,* 288 U. S. 378, 391; *Commissioner* v. *Greene,* 42 Fed. (2d) 852).

Pursuing the same interpolation, the transaction falls within the definition of a reorganization, as follows:

"(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

"(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation"—*United Mortgage Corporation* —"of all or a part of its assets"—*1,000 shares of the capital stock of Monitor Securities Corporation*—"to another corporation"—*Averill Corporation*—"if immediately after the transfer the trans-

> feror" — *United Mortgage Corporation* — "or its stockholders" — *Mrs. Gregory* — "or both are in control of the corporation" — *Averill Corporation*—"to which the assets are transferred, * * *."

Further pursuing the above, the interpolation in Section 112 (i) (2) reads as follows:

> "(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization"—*Averill Corporation* — "and includes both corporations in the case of an acquisition by one corporation"—*United Mortgage Corporation*—"of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation."—*all the stock of Averill Corporation.*

The term "control" is defined in Section 112 (j) as meaning "the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation." As Mrs. Gregory owned all the stock of Averill Corporation she was clearly in "control."

Here then was a "reorganization" exactly within the definition of the statute in Section 112 (i) (l) (B) and an exchange exactly as provided for in Section 112 (b) (4). To effect the expressed intent and purpose of Congress the gain on such transaction is not recognized but is merely postponed until subsequent disposition of the securities received in such reorganization. Let us pursue that postponement through the next step taken in the case at bar.

III-B.

The United Mortgage Corporation distributed to Mrs. Gregory, as its sole stockholder, the stock of the Averill Corporation without the surrender of her stock in United Mortgage Corporation. This transaction resulted in no taxable gain to Mrs. Gregory under the specific provisions of Section 112 (g) of the Revenue Act of 1928.

The United Mortgage Corporation distributed to Mrs. Gregory, as its sole stockholder, the stock of the Averill Corporation without the surrender of her stock in United Mortgage Corporation. Section 112 (g), with appropriate interpolations, reads as follows:

> "(g) *Distribution of stock on reorganization.*—
>
> "If there is distributed, in pursuance of a plan of reorganization, to a shareholder" — *Mrs. Gregory*—"in a corporation a party to the reorganization" — *United Mortgage Corporation*—"stock or securities in such corporation or in another corporation a party to the reorganization" — *Averill Corporation* — "without the surrender by such shareholder" — *Mrs. Gregory* — "of stock or securities in such a corporation"—*United Mortgage Corporation*—"no gain to the distributee"—*Mrs. Gregory*—"from the receipt of such stock or securities shall be recognized."

The distribution by United Mortgage Corporation to Mrs. Gregory of the stock of Averill Corporation is the particular transaction to which the Circuit Court of Appeals in its opinion in this case attributes taxable gain. It is seen from the foregoing that this transaction, coupled with the antecedent one dis-

cussed under III-A., fits literally within the terms of the reorganization provisions of the statute and, unless the exact language of the statute is to be ignored, no gain can possibly attach to the distribution of Averill stock.

That the language was carefully chosen to accomplish this result is fully established by the legislative history of this Section. The transaction here dealt with is a precise parallel of the transactions held taxable by this Court in *U. S.* v. *Phellis,* 257 U. S. 156, and *Rockefeller* v. *U. S.,* 257 U. S. 176, both decided November 21, 1921, construing the provisions of the Act of 1913. The changed policy represented by the provisions of the Revenue Act of 1924 and repeated in the subsequent Acts is fully dealt with in the petitioner's brief in this case, on pages 14-23 and will not be repeated here. Clearly the Circuit Court cannot be supported in its finding that this transaction —the receipt by Mrs. Gregory of the Averill stock— is subject to taxation.

Here again the distribution of the Averill stock is exactly within the purview of the statute (Section 112 (g)). The expressed purpose of Congress is not to recognize gain upon such a distribution but again to postpone recognition until subsequent disposition of the Averill stock. The postponed recognition of profit must, therefore, be pursued into the subsequent transactions.

III-C.

Under the provisions of Section 113 (a) (9) of the Revenue Act of 1928, the basis of cost of Mrs. Gregory's United Mortgage Corporation stock was apportioned in part to the newly acquired Averill Corporation stock.

Not only did the sections of the statute involved in this case define in precise and definite terms those transactions to which taxable gain should or should not be attributed but where taxable gain was not to be attributed to a transaction, the sections further define the effect of those provisions upon subsequent transactions dealing with the same property. At this point we turn to the statute again to determine the effect of the antecedent transactions upon Mrs. Gregory's basis for subsequent transactions, both as affecting her stock in United Mortgage Corporation and her new stock in Averill Corporation.

Section 113 (a) (9), by exact reference to Section 112 (g), *ante*, outlines the basis for subsequent transactions in these stocks by Mrs. Gregory. With interpolations as before, this Section reads as follows:

> "SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS."
>
> "(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—"
>
> "(9) *Tax-free distributions.*—If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in Section 112 (g), the basis in the case of the stock in respect of which the distribution was made"—

> *United Mortgage Corporation*—"shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock" — *United Mortgage Corporation* — "and the stock" — *Averill Corporation* — "or securities distributed;"

Under the authority granted in Section 113, the Commissioner promulgated Regulations 74, Article 600. This regulation, prior to its amendment in 1929, and, as originally drawn and in force at all times material to this case reads, so far as here pertinent, as follows:

> "Art. 600. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 112 (g) and article 576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules;"
>
> "(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quo-

> tient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class."

The computation of Mrs. Gregory's investment in Averill Corporation stock, arrived at in accordance with the foregoing regulations, is set forth in the Record, page 23.

The foregoing provisions of the statute and regulations have an important effect upon subsequent transactions of United Mortgage Corporation, of Averill Corporation, and upon Mrs. Gregory's individual transactions in those stocks. As so applied, Mrs. Gregory's cost, originally $350,000.00, of her stock in United Mortgage Corporation is reduced by $57,325.45, the apportioned cost to Averill Corporation. Upon subsequent disposition of United Mortgage Corporation stock, her cost per share, therefore, is proportionately reduced and her gain increased. In like manner, upon a disposition of Averill stock the basis is provided for under the law and the regulations. Moreover, in the case of dividends in cash, there is a further important effect. Section 112 (h), following Section 112 (g), *ante*, provides, with interpolations, as follows:

> "(h) *Same—effect on future distributions.* —The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization,"—*United Mortgage Corporation*—"of its stock or securities or stock or securities in a corporation a party to the reorganization," — *Averill Corporation*—"shall not be considered a distribution of earnings or profits within the meaning of Section 115 (b) for the purpose of deter-

mining the taxability of subsequent distributions by the corporation."—*United Mortgage Corporation.*

So far as material, Section 115 (b) reads as follows:

> "SEC. 115. DISTRIBUTIONS BY CORPORATIONS."
>
> "(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits."

If, as determined by the Circuit Court of Appeals, the distribution by United Mortgage Corporation of the Averill stock was an ordinary dividend, contrary to the specific direction contained in Section 112 (g), and to the provisions of Section 115 (b), then Section 112 (h) must be disregarded. If Section 115 (b) applies to the distribution of the Averill stock, the earnings available for distribution thereafter by United Mortgage Corporation are reduced by $133,333.33, thereby making it possible for United Mortgage Corporation to distribute, as a charge against capital and not as a charge against income, an equivalent amount in cash to Mrs. Gregory free from tax. In precise language and with obviously full knowledge of the interlocking effect of such transactions, Congress provided that the distribution under Section 112 (g) should not have the effect of a distribution of earnings, so that when earnings were really distributed, there would be no question as to their taxability as dividends. To hold, as the Circuit Court of Appeals holds in this case, that a distribution falling

literally within the terms of Section 112 (g) is a distribution of a taxable dividend, is to throw into confusion all subsequent transactions of United Mortgage Corporation and all others in like situations in respect of their earnings.

If the Averill Corporation stock distribution did not accomplish an apportionment of the cost of stock by the United Mortgage Corporation and Averill Corporation, then it must also follow that on a sale of United Mortgage Corporation stock Mrs. Gregory's basis is $350,000, a result again in direct conflict with the provisions of the statute and again throwing the interpretation of the statutory provisions into hopeless confusion, producing possibilities of double taxation and opening avenues of escape from taxation depending upon the special situations surrounding each particular case.

From the foregoing it will be seen that as a corollary of the postponement of the recognition of gain (explained in captions "A" and "B") the new property is taken by the present holder "with the profit on." To accomplish this an allocation of the basis of the original property is specifically made by the Congress in Section 113 (a) (9) as explained. Such a provision necessarily contemplates a subsequent transaction upon which the postponed profit will be recognized and the gain computed against the basis provided. That transaction took place in the next step taken in the present case.

III-D.

Averill Corporation dissolved and distributed to Mrs. Gregory, in exchange for her stock in that corporation, the 1,000 shares of stock of Monitor Securities Corporation. This was a distribution in liquidation as defined in Section 115 (c) of the Revenue Act of 1928. It was specifically excluded from consideration as a dividend by the provisions of Sections 115 (a) and (b) and 112 (h) of that Act.

Averill Corporation dissolved and distributed to Mrs. Gregory, in exchange for her stock in that corporation, the 1,000 shares of stock of Monitor Securities Corporation. That distribution of the stock of Monitor Securities Corporation in the dissolution of Averill Corporation is the transaction reported by the taxpayer in her return as subject to capital gain tax.

Section 115 of the Revenue Act of 1928 contains explicit directions covering the taxation of corporate distributions. The transaction hereinabove outlined is directly covered by Section 115 (c) which, with interpolations, reads as follows:

> "SEC. 115 DISTRIBUTIONS BY CORPORATIONS."
>
> "(c) *Distributions in liquidation.*--Amounts distributed in complete liquidation of a corporation" — *Averill Corporation* — "shall be treated as in full payment in exchange for the stock"—*Averill stock, apportioned cost $57,325.45*—"and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee"—*Mrs. Gregory* — "resulting from such exchange" — *Averill for Monitor Securities* — "shall be determined under Section 111, but

shall be recognized only to the extent provided in Section 112 * * *."

An examination of Section 111 discloses that there are no adjustments in the instant case to be made, as therein provided.

An examination of Section 112 discloses no circumstances in the instant case requiring the exclusion from taxable gain of any portion of the Monitor stock other than the cost attributed to it by reason of the apportionment of the original basis of cost of United Mortgage Corporation stock.

Sections 115 (a) (b) and (c) define in both inclusive and exclusive terms those distributions by corporations which are and are not to be deemed taxable dividends. To the extent necessary for the purpose of this brief, Section 115 (c) has been quoted on page 22 above. By reference to Section 112 (h) quoted on page 19 above, Section 115 (c) completes the statutory scheme. The last sentence of 115 (c), containing this reference, reads as follows:

"SEC. 115. DISTRIBUTIONS BY CORPORATIONS."

"(c) *Distributions in liquidation.* * * * In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of Section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation."

The foregoing analysis has shown, step by step, the manner in which the transactions in this case fit literally and by intendment into the statutory words and into the statutory plan. The steps so analyzed are those leading up to and including the transactions reported as taxable by Mrs. Gregory and approved by the Board, determined by the Commissioner to be taxable and upon which the Circuit Court imposed tax.

The legal chain was completed by Section 101 (c) (8) (C) which, to the extent that Mrs. Gregory's investment in United Mortgage Corporation stock had been held more than two years, provided that the stock of Averill Corporation acquired by her should be treated as taking the place of the United Mortgage Corporation stock for the purpose of determining the period of time during which such stock was held. By reason of this extension of time, applicable to Averill stock, the gain realized on the liquidation of that stock was taxable at capital gain rates. That gain was realized by the exchange of Monitor stock for the Averill stock in the liquidation of the Averill Corporation.

Here once more the step taken is specifically provided for in the statute (Sec. 115 (c) and Sec. 101). Congress, however, provides for no further postponement of recognition of gain in such a liquidation. Accordingly gain is computed against the basis provided (caption "C"). Here is the ultimate point at which Congress provides for taxing the postponed profit.

IV.

The statute is a carefully articulated plan to provide in specific terms just how capital transactions are to be taxed. There is no room therein for interpolation of an intendment beyond the words used. It is impossible to depart from these interlocking provisions without rendering uncertain all capital transactions involved in corporate reorganizations.

The Court below has previously said, in *Delaware and Hudson Company* v. *Commissioner*, 65 F. (2d) 292, 293:

> "A taxing system so detailed and particular as ours does not admit of the same flexibility of interpretation as one in more general terms. Perhaps its very refinement may defeat its purpose; elaboration often does. But the more articulate the expression, the less room remains for intendment beyond the words used."

It would be difficult to find a happier statement of the principle which the same court appears to have violated in the decision rendered in the present case. The statute under construction is highly articulated. Step after step has been foreseen and prescribed with exact particularity. Each provision is a part of a fabric designed to cover every reasonably anticipable situation. A departure from a literal interpretation at any place in the structure distorts or vitiates the remaining provisions. The sequence must be followed literally through all the interlocking provisions to accomplish the expressed intent and purpose of the Congress.

The primary purpose of this brief has been to call to the attention of the Court the fact that Sections 111 to 115, inclusive, of the Revenue Act of 1928,

and the corresponding sections of earlier and later Acts, represent a carefully articulated plan which, together with Section 101, the capital gain provision, undertook to delimit with extreme care and in specific terms just how capital transactions were to be taxed. It is impossible to depart from these specific provisions without doing violence to all rules of statutory construction. It is impossible to depart from any one of these specific interlocking provisions without rendering uncertain the application of the income tax to all capital transactions which relate in any way to corporate stock or securities or to property exchanged therefor or derived therefrom. Such uncertainty will deter transactions in capital assets which the capital gain provisions by granting a lower rate of tax are intended to induce. Such uncertainty of construction, if adopted, would produce endless litigation, would result in the collection of unjust and unintended taxes in many cases, and would permit in many others an entire escape from taxes intended by Congress to be imposed.

Counsel believe that this Court should reverse the decision of the Circuit Court of Appeals for the Second Circuit and should affirm the decision of the Board of Tax Appeals. It is believed that the decision of this Court should announce, in effect, that the spirit of this statute requires that it be construed as written. This means that the words in Section 112 (i) (l) (B) defining a reorganization are to be lit-

erally applied so that subsequent transactions will be taxed in the manner set forth in the related sections of the statute.

Respectfully submitted,

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